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No. 820

In the Supreme Court of the United States

OCTOBER TERM, 1957

CAPITOL COAL CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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REPLY BRIEF FOR PETITIONER

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No. 830

Capitol Coal Corporation,
Petitioner,

v.

Commissioner of Internal Revenue,
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REPLY BRIEF FOR PETITIONER

In our petition for certiorari we stated that the decision below conflicted with the decision of the United States Court of Claims in *Quincy Mining Company* v. *United States*, 156 F. Supp. 913 (Ct. Cl. 1957). We respectfully submit that the respondent's brief in opposition scarcely obviates the need for this Court's expeditious intervention.

The *Sloane* and *Waynesboro Knitting Co.* cases are not in point.

Sloane v. *Commissioner*, 188 F. 2d 254 (6th Cir. 1951), and *Waynesboro Knitting Co.* v. *Commissioner*, 235 F. 2d 477 (3d Cir. 1955), cited (Resp. 7) by respondent to buttress the decision below, fall wide of the mark.

In the *Sloane* case, the court, with little difficulty, dismissed a distended claim that an amount representing compensation for services rendered to bondholders in the management and sale of certain property was a "recovery" of prior losses on investments in corporate bonds rendered worthless because of a foreclosure sale of such property. The *Sloane* case affords respondent little comfort.

In the *Waynesboro* case, the court rejected a contention that a gain on life insurance policies (realized only by reason of the death of the insured, one of its officers) accepted a decade earlier by the taxpayer-corporation pursuant to a settlement relinquishing its claims against the officer was a "recovery" of the earlier loss sustained as a result of the prior settlement. The pertinence of the decision is rather ephemeral, considering the disparity in the factual situations and the stress placed by the Third Circuit on the fact that the officer's obligations were completely extinguished at the time of the settlement (Capitol Coal's obligations persisted until and were extinguished only by the concellations of indebtedness effected in the taxable year).

Finally, it is difficult to reconcile the decision below with *Amsco Wire Products Co.*, 44 B.T.A. 717 (1941), where the tax benefit ruled was deemed properly applicable in a case involving cancellations of indebtedness (arising by reason of unpaid salaries). Although petitioner stressed in oral argument and in brief the controlling weight of the *Amsco* case, the decision below makes no mention or reference to the holding therein.

The statutory references discussed in respondent's brief are inapplicable to the case at bar.

In his discussion of Section 22(b)(9) of the Internal Revenue Code of 1939, respondent failed to note that it applied only to indebtedness evidenced by a "security" (defined as a bond, debenture, note, certificate or other evidence of indebtedness issued by the corporation).[1] In the case at bar, Capitol Coal's indebtedness to its creditors was not evidenced by a security. Whatever limiting rule implicit in Section 22(b)(9), it can have no application here.

Furthermore, Section 22(b)(9) was intended to exclude from income "amounts which would otherwise be taxable to the debtor under the general principles of tax law".[2] In the case at bar, the precise question in issue is whether any amount is taxable to the petitioner-debtor under the tax benefit rule. The resolution of this initial issue is a prerequisite to the application of Section 22(b)(9); and once resolved, resort to Section 22(b)(9) becomes meaningless.

The respondent has failed to meet the basic contention advanced by petitioner.

In our petition for certiorari (Pet. 12) we maintained that the *Quincy* case proceeded on the premise

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[1] Section 108(a) of the Internal Revenue Code of 1954, unlike Section 22(b)(9) of the 1939 Code, applies to income attributable to the discharge of indebtedness whether or not such indebtedness is evidenced by a security; however, Section 108(a) of the 1954 Code has no pertinence to the taxable year 1942, here involved.

[2] Mertens, Law of Federal Income Taxation, Code Commentary, Ch. 1, Subch. B, page 69.

that there was no tracing requirement in Section 22(b)(12) whereas the courts below proceeded on a contrary premise. Nowhere in respondent's brief is this proposition challenged.

Respondent has seemingly shifted his position for now he presses the point that in the present case "the assets in connection with which the debts arose had been disposed of long before the taxable year" (Resp. 8). This limitation, grafted upon the tax benefit concept, is without legislative or judicial sanction. In *Dobson* v. *Commissioner,* 320 U.S. 489 (1943), the tax benefit rule was sustained even though the assets (shares of stock) in connection with which the losses arose had been disposed of long before the taxable year of recovery.

Respondent also presses the point that "There is here no question of adjusting the basis of assets sold; * * *" (Resp. 8). Conceded; but what matter? In the *Quincy* case, there was no adjustment of the basis of assets sold. The Court of Claims there found that the costs had been incurred in the earlier loss years; so, in the case at bar, the Tax Court found that the debts had been incurred in petitioner's fiscal year 1939—a loss year. In the *Quincy* case, income was realized in a year subsequent to the loss years in which the costs were incurred. So, too, in the case at bar.

The determinative element underlying the decision in the *Quincy* case was the overall loss for the earlier years, devoid of any tracing requirement. In the case at bar, the Second Circuit proceeded upon a contrary theory.

CONCLUSION

The petition for certiorari should be granted to resolve the conflict between the decision below and the *Quincy* case.

Respectfully submitted,

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April 14, 1958.